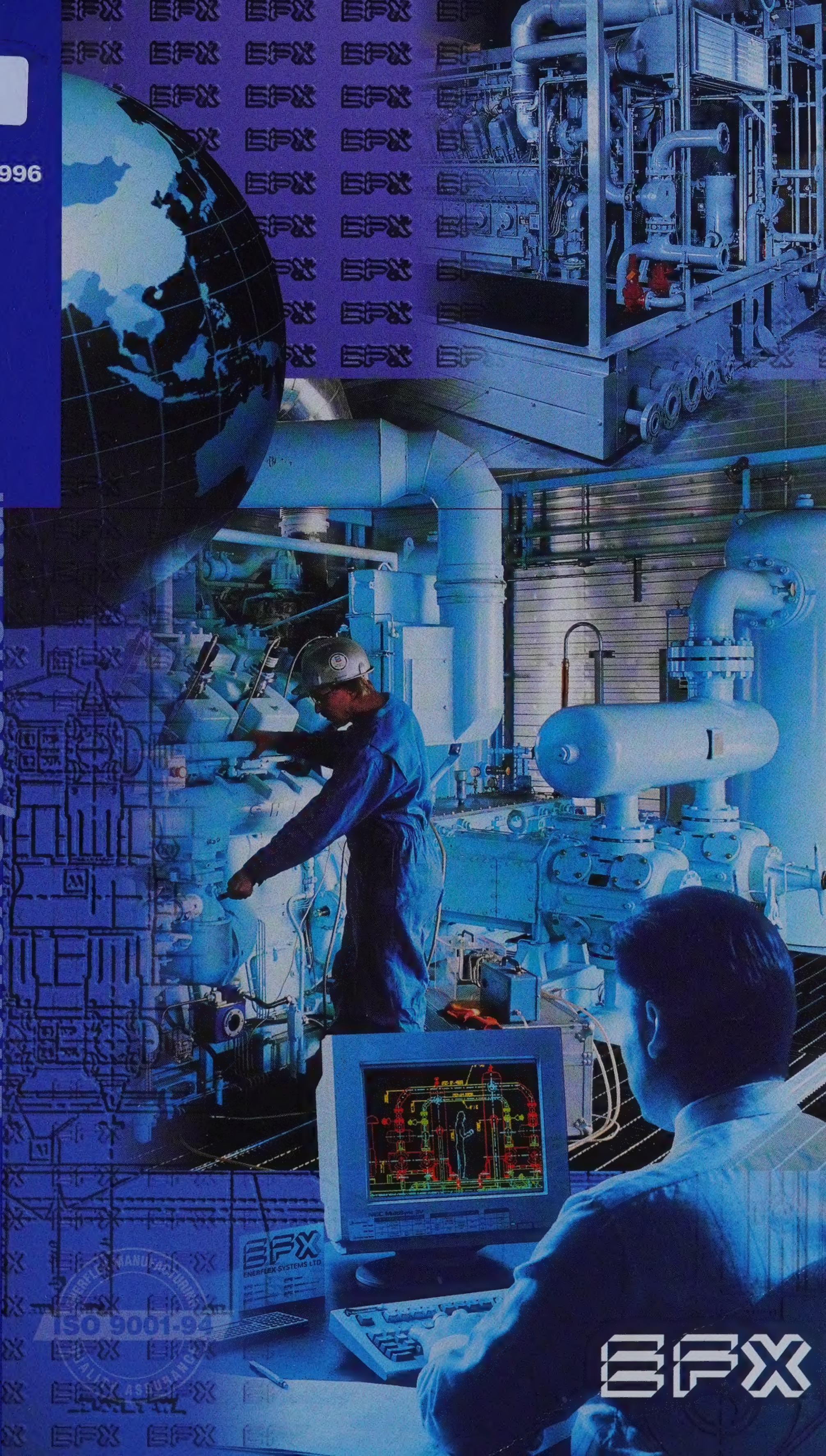
AR58

Annual Report 1996

Enerflex Systems Ltd.



EFX

Company Profile

Enerflex Systems Ltd. manufactures, services and leases compressor packages for the production and processing of natural gas. In addition, the Company manufactures and services gas engine power systems.

The Company comprises six operating divisions:

STRUCTURE

Enerflex Systems Ltd.

- **Enerflex Manufacturing** – Global leader in custom engineering and fabrication of modular compression facilities.
- **Pamco** – Largest supplier in Canada of repair parts and service for natural gas engines, compressors, generators and pump drivers.
- **Compression Services** – Dominant specialist in the reapplication and modification of natural gas compressor packages.
- **BTB Compressors** – Innovative builder of standard pre-engineered compressor packages for the global gas industry.
- **Enerflex Leasing** – Leading Canadian provider of leased and rental modular compression equipment.
- **Gas Drive Systems** – Australian leader in power generation and co-generation. Waukesha engines and Ariel compressors distributor.

Enerflex markets its products and services worldwide. Based in Calgary, the Company has 708 employees.

Mission Statement

We are a customer-driven worldwide supplier of products and services to the natural gas production and processing industry. We are committed to being the industry leader in quality, service and innovation. Our success is measured by our customers' belief that they receive good value for their money. Our values are our customers' values – what is important to our customers is important to us.

To achieve our success we must invest in improving and developing our people and our capabilities. This investment must come from profits. We regard our people and suppliers as vital to our growth and development.

The Annual Meeting of Shareholders will be held at 2:00 pm on Tuesday, April 22, 1997 in the Belaire Room at the Westin Hotel, Calgary, Alberta.

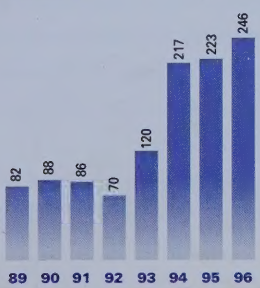
Financial Highlights

(Thousands of dollars, except per share data)

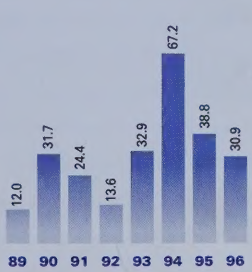
		1996	1995	1994
Results				
Revenue		**245,922**	222,714	217,342
EBITDA*		**32,437**	32,226	33,839
Income before income taxes		**27,777**	26,908	30,168
Net income		**16,543**	16,139	17,779
Cash from operations before changes in non-cash working capital		**19,667**	21,937	18,923
Capital expenditures, net				
Rental equipment		**(2,236)**	152	8,568
Property, plant and equipment		**2,722**	3,697	7,161
Dividends		**3,765**	3,767	2,644
Financial Position				
Working capital		**37,674**	26,862	12,989
Total assets		**106,398**	91,801	102,505
Long-term debt		**–**	4,634	4,716
Shareholders' equity		**66,407**	53,599	41,593
Ratios and Per Share Data				
Gross margin as % of revenue		**21.4%**	22.3%	23.6%
Pre-tax income as % of revenue		**11.3%**	12.1%	13.9%
Return on opening equity		**30.9%**	38.8%	67.2%
Common shares outstanding (000s)		**7,536**	7,531	7,557
Net income per common share	– basic	**2.20**	2.14	2.35
Price range	– high	**36.50**	18.00	19.50
	– low	**16.38**	12.25	14.00
	– close	**33.00**	16.75	17.38

**Earnings before interest, taxes, depreciation and amortization.*

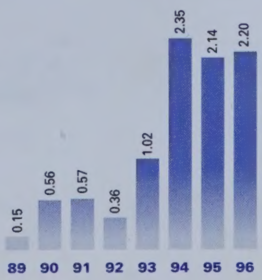
Revenue
($ millions)



Return on Equity
(%)



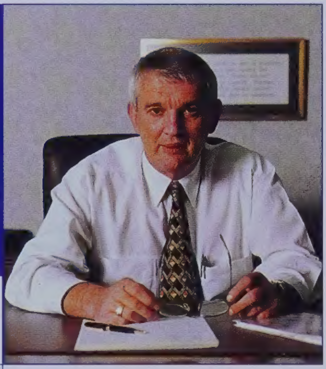
Net Income Per Common Share
($)



Message to Shareholders

1996 was an eventful and challenging year for your Company. The year started with weak natural gas prices and a great deal of industry concern over lack of export pipeline capacity. A combination of steady improvement throughout the year in market fundamentals and our position as the market leader have culminated in far stronger results than we anticipated at the beginning of the year.

Revenues increased by 10% to $245.9 million while earnings increased by 2.5% to $16.6 million or $2.20 per share resulting in a return on shareholders' equity of 31%. During the course of the year, total debt expressed as a percentage of shareholders' equity declined from 24% to 7% at year end. The net book value of the Company grew by 24% over the 12 month period.



P. John Aldred
President and Chief Executive Officer

It is important to note that there is a delay of approximately six months between the time our customers determine the need for compression equipment and the point at which our results reflect shipment of the finished system. We are pleased that in addition to delivering strong results in a market emerging from weakness, we have also been able to rebuild our backlogs to historically high levels.

In early August, we announced that we had retained a New York based firm of investment bankers with experience in our industry to assist in the search for a strategic partner. We pursued this initiative for two primary reasons:

- We believed that the right partner could dramatically accelerate the attainment of our stated goal of becoming a dominant force in the global gas compression industry.
- At the time there was a huge disparity between Canadian and U.S. public market valuations of companies in the energy service sector rendering Enerflex unable to effectively pursue any potential cross-border acquisitions.

Enerflex entered this process from a position of strength allowing us to carefully consider each potential partnership or transaction against a range of important criteria. Strategic fit on a global basis, value to our shareholders and impact on our major suppliers, existing customers and employees were issues that we considered in detail.

After a long and exhaustive search, we concluded that no single interested party was in a position to provide a comfortable balance in these areas, leading us to terminate this initiative. We are keenly aware of the time and effort expended by prospective partners during this process and would like to express our thanks and appreciation to these organizations.

The world around us changed significantly while this initiative was under way. The gap between Canadian and U.S. price/earning multiples has narrowed significantly in the energy service sector. Market conditions for our products and services in Canada and around the world have shown a marked improvement during this period.

Over the course of the year, we focused increased marketing and technical resources on our international markets with results that exceeded our expectations. Today, we have a strong belief in our ability to continue growing Enerflex on a global basis.

During 1996, international revenues increased by 85% over 1995. In addition to the dramatic growth in value, projects became broader in scope, more diverse and increased in sophistication. Contracts ranged from the turnkey supply, installation, operation and maintenance of a nine megawatt power station in Alice Springs, Australia to the supply, installation and commissioning of four 3,000 BHP gas injection compressor systems in Poland.

1996 also marked the emergence of a new market for Enerflex. Floating production, storage and off loading (FPSO) vessels enable producers to develop and produce offshore reserves without the need for onshore facilities and related underwater pipelines. Typically, these vessels require sophisticated compression systems.

Enerflex Manufacturing shipped its first FPSO system in 1996 for use offshore New Zealand, and secured the largest contract in the division's history for the design and supply of compression equipment for an FPSO vessel destined for the North Sea. We anticipate a significant number of these projects will emerge over the next several years. Enerflex has an ideal skill set for this market. Our sophisticated engineering, design and project management capabilities, coupled with certification under the ISO 9001-94 quality program, will allow us to be a significant player in this market.

Canada continues to be our prime market. The ability to provide local product support is vital, and to this end our Pamco division continued to make significant investments in upgrading and expanding existing branch facilities, adding a new branch in Ft. Nelson, British Columbia and establishing a fully equipped training facility for both employees and customer personnel.

At its February 5, 1997 meeting, the Board of Directors announced a 20% increase in the quarterly dividend, raising it to 15 cents per share from 12.5 cents. The increase brings the annual rate to 60 cents per share compared to 50 cents last year. The new dividend rate is appropriate in view of the Company's strong balance sheet and cash flow.

We will be presenting a proposal to shareholders at our Annual and Special Meeting on April 22, 1997 recommending a two for one subdivision of common shares. We believe that a subdivision is appropriate at this time and should enhance the liquidity of Enerflex shares.

The outlook for 1997 is very positive. We enter the year with a substantial backlog of firm orders, sound market fundamentals and strong momentum. The planned expansion of export pipeline capacity in 1998 should start to impact our business levels late in 1997 and we feel confident in our ability to grow our international revenues. Barring any currently unforeseen shifts in the natural gas markets, we anticipate stronger results in the coming year.

We wish to thank our shareholders, customers, suppliers and employees for their support and patience during an eventful year.

P. John Aldred President and Chief Executive Officer	**Robert M. Ogilvie** Chairman

1996 Global Projects

Canada
- Sweet gas gathering
- Sour gas gathering
- Process plant inlet
- Sour gas boosting
- Pipeline transmission/ boosting
- Process refrigeration
- Solution gas
- Acid gas injection
- Power generation
- Co-generation
- Process gas recycle/ stabilization
- Pipeline testing (air)
- Inert gas reinjection
- Gas storage

Venezuela
- Gas plant process

Norwegian Sector North Sea
- Gas recovery
- Gas reinjection (gas lift)
- Floating production storage and offloading

Poland
- Gas storage

Ukraine
- Gas gathering

Slovakia
- Gas storage

Guatemala
- Sour gas gathering

Argentina
- Gas gathering

Dutch Sector North Sea
- Gas lift

Pakistan
- Gas plant process

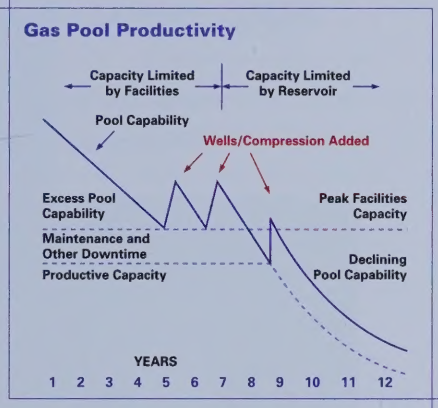
Indonesia
- Fuel gas booster

Australia
- Gas plant process
- Permeate gas
- Gas gathering
- Rental gas gathering
- Pipeline boosting
- Power generation
- Co-generation
- Sewage gas co-generation
- Land fill gas co-generation

Review of Operations

Enerflex Systems Ltd. manufactures, services and leases compressor packages for the production and processing of natural gas. The Company also manufactures and services gas engines and power systems.

Gas compression equipment is generally used to increase the pressure within gas gathering systems and processing plants to enable the delivery of gas to mainline transmission facilities and finally to market. In a typical gas field, several compressors may be required to sustain the pressure necessary to deliver gas to the main high pressure transmission facility.



Compression can significantly improve the economic value of existing reservoirs.

Demand for compression equipment results from additional production as new wells are drilled and from the declining reservoir pressures of existing fields. A combination of additional compression and development drilling is invariably required to maintain production volumes in the face of declining reservoir pressures.

A typical compressor package consists of a steel or concrete skid or base, gas compressor, driver (reciprocating engine, gas turbine or electric motor), process cooler, gas clean up and vibration attenuation equipment, process piping and a control system. In colder climates, the system is enclosed in an insulated building. The size of packages generally range from 50 to 6,000 HP.

Compressor packages are designed and manufactured to stringent industry specifications and successful packagers must be able to produce to the highest quality standards. Since its inception 17 years ago, Enerflex has been providing increasingly innovative modularized compression systems and is the only company in Canada that offers a total range of capabilities to the gas compression and power generation market, including design, manufacture, project management, lease financing, installation, commissioning, and after-sales service and support.

Enerflex has attained a dominant position in the Canadian market through its focus, commitment, technical innovation and high quality standards. These same strengths are enabling Enerflex to continue to build its international reputation and to become a leading supplier of gas compression equipment worldwide.

Enerflex Systems Ltd. operates with a lean corporate staff and is organized into six distinct divisions. Each division operates as an autonomous business unit focused on a specific sector of the gas compression and power generation business, but gains strength and capability through its relationship with the other divisions.

ENERFLEX *Manufacturing*

Enerflex Manufacturing is emerging as a global market leader in the custom design, fabrication and installation of modular compression facilities for the production and processing of natural gas and specialized applications such as gas injection and storage. The division occupies 137,000 square feet of shop and office space on approximately 10 acres of land.

One of four 3,000 HP Poland bound compressor modules loading into an EFX chartered Russian Antonov aircraft.

In 1996, the division accounted for slightly over 50% of Enerflex's revenues with shipments of more than 95 modular systems, totalling approximately 130,000 HP. Direct production manhours exceeded 1995 by approximately 5% and matched the record levels reached in 1994. Manufacturing entered the year with a relatively modest backlog and faced uncertain domestic market conditions. However, as the year progressed, a steady recovery in the domestic market and continued success in penetrating the international market resulted in improved financial results, particularly in the last two quarters.

During 1996, Enerflex Manufacturing achieved an all time high in terms of order bookings and enters 1997 with a substantial backlog. International activity continues to be increasingly significant to Enerflex Manufacturing's business and the division is on target to achieve its goal of having international orders account for 50% of its business within the next few years.

In 1996, the division continued to successfully engineer and project manage technically demanding projects with unusual applications and rigorous specifications. The following projects were noteworthy in 1996.

- Design, manufacture, transport, install, and commissioning of 12,000 HP gas storage compression at two sites in Poland. Project time frames were on a "fast track" basis requiring innovative air shipments of major components.
- Design and manufacture of four compressor modules for a floating production storage and off loading (FPSO) vessel to operate in the Norwegian North Sea. This project requires compliance with the rigorous Norwegian offshore design and construction standards and is the largest single order ever received by Enerflex Manufacturing. Delivery is scheduled for mid 1997.
- Design, manufacture, transport and installation of 8,000 HP of sour gas, refrigeration, acid gas and process gas compression as well as power generation equipment for the first acid gas injection facility in British Columbia.

A typical floating production storage and off loading vessel (FPSO).

- Design and manufacture of 8,500 HP sour gas gathering compression for Northern British Columbia burning sour gas fuel.
- Design and manufacture of 7,500 HP gas storage/ withdrawal compression for a new underground gas storage facility in Central Alberta.

The Manufacturing division is committed to setting the highest standards in the design, manufacture and installation of gas compression systems throughout the world and it operates as an ISO 9001-94 certified organization. Its success in the global market has been achieved through technical excellence and its ability to meet or exceed demanding international quality standards. Enerflex Manufacturing has the capabilities to successfully manage the largest and most complex gas compression projects anywhere in the world.

PAMCO

Pamco is the largest supplier of parts and maintenance services for natural gas engines and compressors in Canada. Pamco also supports the other Enerflex divisions in both their domestic and international operations. In addition, the Pamco Power Products group markets industrial engines and manufactures gas engine power systems.

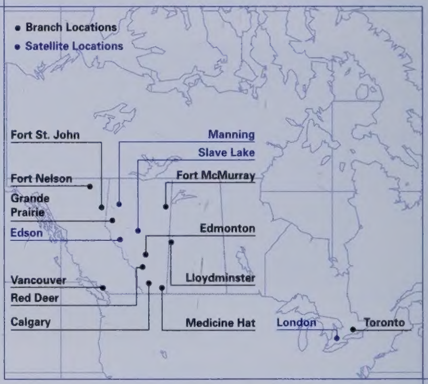
Pamco has more than 200 employees, 55 fully equipped service vehicles and operates 15 parts and service branches, two manufacturing facilities and the EFX Training Center. Pamco provides a comprehensive range of services including preventative maintenance, trending analysis, onsite trouble shooting, diagnostic testing and complete unit overhauls. Parts and workmanship are covered under a warranty backed by 24 hours a day, seven days a week service. Services are also provided under long-term maintenance contracts.

Pamco operates Canada's largest fleet of vehicles to service the natural gas industry.

Pamco is the Canadian distributor for Waukesha engines, Ariel compressors and Dresser-Rand compressor parts. Other lines are represented on a national or regional basis including Mechanical Equipment (catalytic converters), Energy Dynamics (engine parts), Precision Engine Controls (air/fuel ratio controllers) and Arrow Specialties (natural gas engines).

In 1996, Pamco significantly expanded the line of compressor parts under its distribution agreement with Dresser-Rand.

Revenues from Pamco's operations increased by 16% in 1996, accounting for approximately 25% of Enerflex's total revenue. The outlook for 1997 is positive as the installed base of equipment continues to grow and operating load factors remain high.



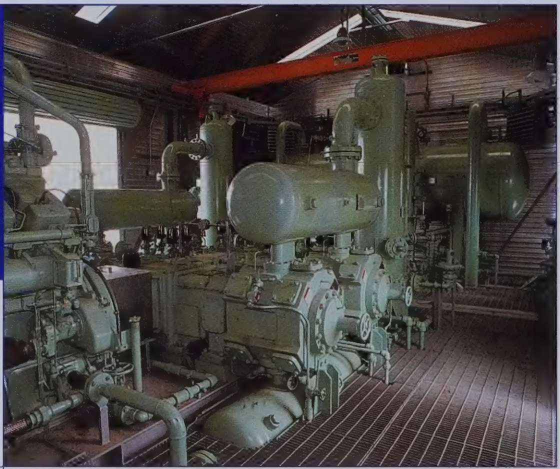
Pamco locations across Canada.

EFX COMPRESSION*Services*

Compression Services is the leading specialist in the re-engineering and retrofitting of natural gas compressor packages and the supply of new compressor packages using re-manufactured components.

Over the life cycle of a compressor, the reservoir pressure of the gas field will change, requiring re-engineering and revamping of the package to optimize operations.

A refurbished ten-year-old engine and compressor incorporated into a modern self-contained module.

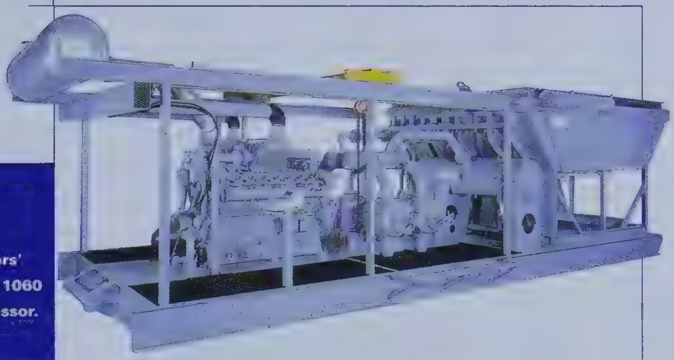


Compression Services has an experienced engineering team along with shop fabrication and field installation capabilities to respond rapidly to customer requirements. Work is performed in the division's modern 44,000 square foot shop or in the field, depending on the magnitude and nature of the work and whether or not the compressor is to be moved.

More than 5,000 gas compressors have been installed in Western Canada since the late 1960s. This expanding and aging fleet has the potential to increase the market for this division. In 1996, Compression Services accounted for 8% of Enerflex's revenues.

EFX BTB*Compressors*

BTB Compressors is the leading manufacturer of standard pre-engineered compressor packages for the natural gas industry. Market acceptance of BTB's standard product continues to grow. The product line includes models in the 145, 250, 400, 550 and 800 HP categories, as well as a 1060 HP unit developed in 1996. A comprehensive array of options is available including electric motor drives, sour gas



BTB Compressors' innovative 1060 HP compressor.

packages and sophisticated instrumentation. These options allow customers to meet their specific site requirements while taking advantage of the quality benefits, cost savings and short delivery times derived from standardization of the product line.

BTB operates from an 18,000 square foot facility in Calgary and maintains a comprehensive inventory of stock compressors and major components to enable quick response to customer orders.

In 1996, BTB became an ISO 9001-94 approved manufacturer and increased its international shipments. BTB accounted for 6% of Enerflex's revenue in 1996.

EFX LEASING

ENERFLEX LEASING LTD.

Enerflex Leasing is the leading provider of leased modular compression equipment to a wide range of natural gas producers in Western Canada. Contracts typically run from a few months to five years and are available with a variety of financing options. Leases can also be combined with full maintenance contracts supplied by the Pamco division.

Enerflex Leasing unit on site.

Synergies with the other Enerflex operations provide the Leasing division with significant advantages in the marketplace. The Manufacturing, BTB Compressors and Compression Services divisions supply fleet equipment to Enerflex Leasing. Pamco supplies parts and service support from its network of branches, and Compression Services reconfigures the equipment for new rental contracts.

Financing options will be an important component of Enerflex's international sales initiatives. In 1996, Enerflex Leasing secured its first international rental contract in Australia.

The fleet is in excellent condition with an average unit age of 2.5 years.

GDS *Gas Drive Systems*

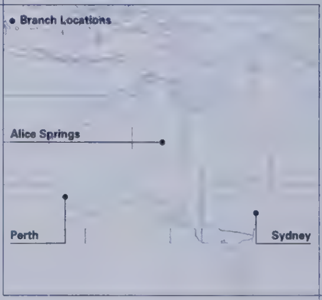
Gas Drive Systems Pty Ltd. (GDS) is a wholly-owned subsidiary based in Sydney, Australia. GDS is the authorized distributor and product support organization for a number of product lines including Waukesha engines and Ariel compressors. The Company markets and manufactures power generation equipment in Australia and supports the sale of compression systems manufactured by other Enerflex divisions throughout Australasia. In addition, GDS has a rapidly growing parts and service operation with branches in Sydney, Perth and Alice Springs.

Nine megawatt base load power station in Alice Springs, Australia.

Gas Drive Systems exceeded expectations in 1996 by again more than doubling sales. Significant projects and achievements include the following.

- Design, supply, installation and ongoing operation and maintenance of a nine megawatt base load power station in the Northern Territory township of Alice Springs.
- Increased penetration into the mining industry with the sale of over 16 Ariel compressors for use as air drilling boosters.
- Growth in the cogeneration segment including the design, supply and commissioning of systems with host sites ranging from an abattoir to sewage treatment works.

While the growth rate of the past two years will be difficult to sustain, the outlook for 1997 is positive. Further orders from the mining industry for power generation equipment are anticipated as natural gas increases in availability as a fuel. Further growth in the parts and service business is also expected as the installed base of equipment grows.



GDS locations across Australia.

Management's Discussion and Analysis

Strategy

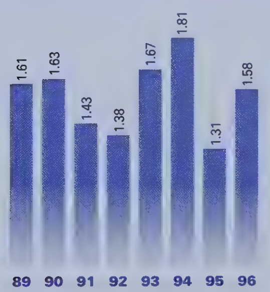
The strategic goals and objectives of Enerflex Systems Ltd. are to:

- aggressively pursue development of our technical and financial engineering capabilities;
- maintain a position of leadership in our domestic market, both in terms of manufactured products and product support services;
- expand internationally through technical excellence and our ability to meet or exceed the most demanding quality standards; and
- become the global market leader in providing engineered gas compression systems and related products and services.

Market Demand

The demand for compression equipment and services is related mainly to the production of natural gas and declining reservoir pressures, and is also influenced by natural gas prices and development activity by gas producers.

Natural Gas Prices
(Alberta Average Plant Rate – $/MCF)



Compression demand is tied to production of natural gas because virtually every cubic foot of natural gas produced requires compression. Total production of natural gas in Canada, estimated at 5.2 TCF in 1996, has risen at a compound annual rate of 7.6% over the last five years. This is due primarily to exports to the United States which, accounting presently for 56% of Canadian production, have grown at a rate of 11.5% a year over this period. Domestic production has been growing at a rate of 3.6% annually.

It is anticipated that the rate of increase in production of natural gas over the next few years will accelerate with the addition of pipeline capacity for export to the United States.

The rate of decline of reservoir pressures in the Western Sedimentary Basin has been increasing since deregulation. Gas producers wishing to maintain production volumes have had to increase the amounts of compression installed. This has resulted in increased demand for both compression equipment and services.

Compression demand is influenced by natural gas prices through their effect on the capital expenditure budgets of gas producers. The average Alberta plant gate price increased to an estimated $1.58 per mcf in 1996 compared to $1.31 in 1995. Ziff Energy Group forecasts the average price will rise to $1.60 per mcf in 1997 and further in 1998 and 1999 as the gas surplus situation is relieved with the expansion of export pipeline capacity.

Compression demand is also affected by producer development activity. Installation of compressors usually follows the drilling of natural gas development wells. Development drilling in Western Canada fell from 3,700 wells in 1994 to 2,400 wells in 1995 and increased to an estimated 2,600 wells in 1996. Ziff is forecasting 2,500 wells in 1997 and renewed activity in 1998 and 1999.

Additional factors driving demand are the need to replace obsolete equipment and the gradual shift of gas operations northward to tap new gas reserves. Gas producer demand for compression equipment overhauls and other services are also driven by the number of installed units and their operating loads and, to some extent, by producers' cash flows.

The accelerating demand for energy in emerging markets such as South East Asia and South America far exceeds developed supplies. Enerflex's international initiatives are expected to mitigate the effect of the cyclical nature of North American natural gas markets on Company operations.

Competition

The Company is the leading manufacturer of natural gas field compression equipment in Western Canada. When the production of the Manufacturing, BTB Compressors and Compression Services divisions are added, the Company accounts for slightly more than half the market. The Manufacturing division has two significant and several smaller competitors.

The Company's competitive advantage in the manufacturing area is based on product quality, engineering expertise, concentrated product lines, modern manufacturing facilities and proprietary computer design systems. The employees are non-unionized and staff turnover is minimal.

Pamco, the product support division, has a large market share in a competitive market. Numerous small to medium regionally focused competitors exist, some of whom operate exclusively for one natural gas company. Many major gas producers have their own maintenance departments and Pamco works with them to varying degrees. Pamco's competitive strengths include the largest network of branches covering most of the Western Sedimentary Basin, exclusive distributorships, dedicated personnel, an effective inventory system, a strong warranty program and synergies derived from the other divisions. In spite of strong industry growth prospects, significant barriers to new entrants to the Company's business exist, including technological complexity and exclusive supply arrangements for key equipment and replacement parts.

Business Risks

World energy prices, affected by market forces and government regulation, influence natural gas development activities carried on by the Company's customers. Canadian government regulations can also increase or decrease the demand for compression equipment and services.

The U.S. dollar exchange rate is not deemed to be a significant risk. As a rule, domestic sales contracts have exchange clauses that protect the Company against variations in the cost of components imported from the U.S. Export contracts are usually denominated in U.S. dollars; however, the Company hedges uncollected amounts with imports of materials and forward exchange contracts. The greatest effect of U.S. dollar exchange variations is felt through the price of natural gas exports and resulting customer development activity as discussed above.

The Company reduces its exposure to economic swings in the North American marketplace through its product support, service and international operations.

Capacity

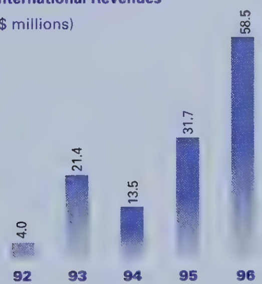
The Company is committed to managing its growth prudently in order to maintain quality of products and services to customers. Enerflex is currently exploring various options to increase capacity incrementally in response to market demand while maintaining the economic return to shareholders.

Financial Results

Revenues in 1996 increased by 10.4% to $246 million from $223 million in 1995. International revenues increased by 85% to $58 million which is almost one quarter of Enerflex's total revenues. This success in the international market follows the excellent results in 1995 and reflects the Company's focus on the development of sustainable overseas markets. Domestic revenues were essentially unchanged at $188 million. This reflects the slower market conditions that were carried over from the latter stages of 1995. During the last two quarters of 1996, domestic activities improved significantly and the backlog going into 1997 is historically high.

Gross margins decreased to 21.4% in 1996 compared to 22.3% in 1995 due to the change in mix of revenues and lower activity levels for domestic compressor sales in the first half of 1996.

International Revenues
($ millions)



Selling, general and administration costs increased 10.1% of revenues to $24.8 million in 1996 from $21.7 million or 9.8% of revenues in 1995. The increase in costs and its percentage relative to revenues was due to the expansion of Pamco's branch operations, increased operations in Australia, and investment in support of global marketing activities.

Interest expense in 1996 declined due to the reduction in both debt and interest rates during the year.

Net earnings increased 2.5% to $16.5 million in 1996. The return on opening equity was 31% in 1996 compared to 39% in 1995 due to the increase in equity. The Company is generating cash flow well in excess of that required to sustain current operations and has announced a 20% increase in the dividend to 60 cents per share. Other cash reserves are being retained to finance increased activity in international markets.

Liquidity and Capital Resources

Enerflex has a strong financial position. At December 31, 1996 the Company had $2.9 million in cash compared to $8.4 million of bank loans a year earlier. The Company generated $15.6 million in cash from operations compared to $11.6 million in 1995. Total term debt of $4.6 million was virtually unchanged in 1996.

Total capital expenditures in 1996 were $4.9 million compared to $13.4 million in 1995. The expenditures in 1996 included $2.1 million for rental units compared to $9.6 million in 1995. The other major expenditures in 1996 related to the expansion of the Pamco branches, equipment purchases and new management information systems at Enerflex Manufacturing.

Ongoing cash requirements for investment in fixed assets is not large in relation to the scope of operations and internally generated cash. Enerflex expects to finance its domestic and international activities, capital expenditures and rental fleet additions in 1997 from its cash flow. In addition to cash generated from operations, $40 million of unused credit from existing bank lines is also available.

Seasonality

The Company's operations are not inherently seasonal with the exception of service activities which are generally higher in the summer months. Quarterly earnings can vary according to the timing of customer demand which in the domestic market is highly influenced by the cash flows and access to capital available to natural gas producers. The quarterly earnings in 1996 improved steadily from 41 cents per share in the first quarter to 72 cents in the last quarter, reflecting improved natural gas prices in the domestic market and a steadily strengthening international order book.

Environment

The Company's exposure to environmental hazards is not material. Periodically, the Company undertakes an environmental assessment by an outside independent firm of environmental consultants. The Company has environmental policies and rules in place and monitors operations for compliance. The Company benefits overall from increases in demand for its products and services stemming from the fact that natural gas is an environmentally friendly fuel.

Safety, Ethics and Governance

The Company has policies and procedures governing safety and utilizes division committees and employee training programs to ensure high standards of safety. The Company believes it is in compliance with its own policies and all government regulations.

In order to ensure high ethical standards, the Company has a Code of Business Conduct which is read and acknowledged by every employee bi-annually.

The Board of Directors follows a system of corporate governance that is more fully described in the Information Circular.

Management's Responsibility for Financial Information

The accompanying consolidated financial statements and all information in the Annual Report have been prepared by management and approved by the Board of Directors. The consolidated financial statements were prepared in accordance with generally accepted accounting principles in Canada and, where appropriate, reflect management's best estimates and judgements. Management is responsible for the accuracy, integrity and objectivity of the consolidated financial statements within reasonable limits of materiality and for the consistency of financial data included in the text of the Annual Report with that in the consolidated financial statements.

To assist management in the discharge of these responsibilities, the Company maintains a system of internal controls designed to provide reasonable assurance that accounting records are reliable and assets are safeguarded.

The Audit Committee is appointed by the Board of Directors. The Audit Committee meets with management as well as with the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the auditors' report. The Audit Committee reports its findings to the Board of Directors for consideration in approving the consolidated financial statements for presentation to the shareholders. The external auditors have direct access to the Audit Committee of the Board of Directors.

The consolidated financial statements have been audited independently by Arthur Andersen & Co. on behalf of the shareholders, in accordance with generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements.

P. John Aldred
President and Chief Executive Officer
February 5, 1997

Robert S. Woodward
Vice-President,
Chief Financial Officer and Secretary

Auditors' Report

To the Shareholders of Enerflex Systems Ltd.:

We have audited the consolidated statements of financial position of Enerflex Systems Ltd. as at December 31, 1996 and 1995 and the consolidated statements of income, retained earnings and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Calgary, Alberta
February 5, 1997

Arthur Andersen & Co.
Chartered Accountants

Consolidated Statement of Financial Position

(Thousands)	December 31 1996	1995
Assets		
Current Assets		
Cash	$ 2,860	$ –
Accounts receivable	59,556	33,654
Inventory (note 1)	13,208	24,557
Total current assets	75,624	58,211
Rental Equipment (note 2)	13,815	16,871
Property, Plant and Equipment (note 3)	15,490	15,204
Goodwill, net of accumulated amortization	1,469	1,515
	$ 106,398	$ 91,801
Liabilities and Shareholders' Equity		
Current Liabilities		
Bank loans (note 4)	$ –	$ 8,418
Accounts payable and accrued liabilities	31,875	24,548
Income taxes payable	1,441	(1,699)
Current portion of long-term debt (note 4)	4,634	82
Total current liabilities	37,950	31,349
Long-term Debt (note 4)	–	4,634
Deferred Income Taxes	2,041	2,219
	39,991	38,202
Shareholders' Equity		
Share capital (note 5)	34,262	34,046
Retained earnings	32,145	19,553
	66,407	53,599
	$ 106,398	$ 91,801

Commitments and Contingencies (note 6)

On behalf of the Board:

P. John Aldred
Director

Ronald G. Willox
Director

Consolidated Statement of Income

(Thousands, except per share and share amounts)

	Year Ended December 31 **1996**	1995
Revenue (note 7)	**$ 245,922**	$ 222,714
Cost of Goods Sold	**193,225**	173,120
Gross Margin	**52,697**	49,594
Expenses (Income)		
Selling, general and administrative	**24,752**	21,726
Interest (note 4)	**763**	1,305
Gain on sale of rental equipment	**(595)**	(345)
	24,920	22,686
Income before Income Taxes	**27,777**	26,908
Income Taxes (note 8)	**11,234**	10,769
Net Income	**$ 16,543**	$ 16,139
Net income per common share – basic	**$ 2.20**	$ 2.14
– fully diluted	**$ 2.14**	$ 2.10
Weighted average number of common shares	**7,531,057**	7,538,273

Consolidated Statement of Retained Earnings

(Thousands)

	Year Ended December 31 **1996**	1995
Retained earnings, beginning of year	**$ 19,553**	$ 7,435
Net income	**16,543**	16,139
Common shares purchased for cancellation (note 5)	**(186)**	(254)
Dividends	**(3,765)**	(3,767)
Retained earnings, end of year	**$ 32,145**	$ 19,553

Consolidated Statement of Changes in Financial Position

(Thousands)

	Year Ended December 31 1996	1995
Operating Activities		
Net income	**$ 16,543**	$ 16,139
Depreciation and amortization	**3,897**	4,013
Deferred income taxes	**(178)**	2,130
Gain on sale of equipment	**(595)**	(345)
	19,667	21,937
Changes in non-cash working capital	**(4,087)**	(10,295)
	15,580	11,642
Investing Activities		
Purchase of:		
Rental equipment	**(2,085)**	(9,607)
Property, plant and equipment	**(2,879)**	(3,749)
Proceeds on disposal:		
Rental equipment	**4,321**	9,455
Property, plant and equipment	**157**	52
	(486)	(3,849)
Financing Activities		
Stock options exercised	**258**	–
Common shares purchased for cancellation	**(228)**	(366)
Dividends	**(3,765)**	(3,767)
Repayment of long-term debt	**(81)**	(76)
	(3,816)	(4,209)
Cash (Bank Loans)		
Increase in cash	**11,278**	3,584
Beginning of year	**(8,418)**	(12,002)
End of year	**$ 2,860**	$ (8,418)

Summary of Accounting Policies

Incorporation and Basis of Consolidation

Enerflex Systems Ltd. (the "Company") is incorporated under the Canada Business Corporations Act. The consolidated financial statements comprise the accounts of Enerflex Systems Ltd. and its subsidiaries.

Revenue Recognition

Revenues from the design, manufacture and installation of equipment are recorded upon substantial technical completion. Any foreseeable losses on contracts are charged to operations at the time they become evident. Revenues from parts and services are recorded when goods are shipped and services are rendered.

Revenue from equipment leases is recorded over the lease term.

Inventory

Manufacturing materials are recorded at the lower of cost (principally on the first-in, first-out method) and net realizable value. Repair parts are recorded at the lower of cost (weighted average) and net realizable value.

Work in progress includes material, labour and manufacturing overhead, and is recorded net of progress billings on a contract by contract basis.

Rental Equipment and Property, Plant and Equipment

Rental equipment and property, plant and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives (three years to 20 years) of the various classes of assets.

Repairs and maintenance costs are charged to operations as incurred. Major renewals and improvements are capitalized. A provision is made in advance for major overhauls on rental equipment.

Goodwill

Goodwill represents the excess of the purchase price over the value attributed to net tangible assets acquired. Goodwill is being amortized over 40 years.

Income Taxes

The deferral method is used in accounting for income taxes whereby timing differences between income reported in the financial statements and taxable income result in deferred income taxes.

Forward Exchange Contracts

In the normal course of business, the Company enters into short-term, foreign currency forward exchange contracts with financial institutions to hedge assets, liabilities or future commitments. Gains and losses arising from these contracts offset the losses and gains from the underlying hedged transactions.

Foreign Exchange

Transactions and non-monetary balances denominated in foreign currency are translated into Canadian dollars using the exchange rates at the dates of the transactions; monetary balances are translated using the exchange rates at the date of the balance sheet.

Notes to Consolidated Financial Statements

(Tabular amounts in thousands)

1. Inventory

	1996	1995
Manufacturing materials	$ 5,176	$ 7,557
Repair parts held for resale	13,188	13,581
Work in progress:		
Costs in excess of related billings	9,243	7,559
Billings in excess of related costs	(14,399)	(4,140)
	$ 13,208	$ 24,557

2. Rental Equipment

	1996	1995
Cost	$ 16,762	$ 19,504
Less: accumulated depreciation	2,947	2,633
Net book value	$ 13,815	$ 16,871

3. Property, Plant and Equipment

	1996		1995	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Land	$ 2,543	$ –	$ 2,411	$ –
Buildings	12,584	(3,784)	11,872	(3,350)
Equipment	15,181	(11,034)	13,339	(9,068)
Total	$ 30,308	$ (14,818)	$ 27,622	$ (12,418)
Net book value		$ 15,490		$ 15,204

4. Debt

The long-term mortgage which matures in 1997 bears interest at 8.21%, is amortized over 25 years, and is secured by land and buildings. Interest on long-term debt was $384,000 for 1996 ($391,000 for 1995).

The Company's operating bank lines of credit total $40,000,000 with interest at bank prime and are secured by general assignment of accounts receivable and inventory.

Notes to Consolidated Financial Statements

(Tabular amounts in thousands, except share amounts)

5. Share Capital

Authorized

The Company is authorized to issue unlimited common shares and first preferred shares.

Issued

	1996		1995	
	Common Shares	Amount	Common Shares	Amount
Balance, beginning of year	7,530,800	$ 34,046	7,557,000	$ 34,158
Stock options exercised	14,800	258	–	–
Common shares purchased	(9,200)	(42)	(26,200)	(112)
Balance, end of year	7,536,400	$ 34,262	7,530,800	$ 34,046

Shares Purchased

The purchases of common shares were made pursuant to normal course issuer bids.

Stock Options

The Company has reserved 750,000 common shares under the terms of an employee stock option plan. At December 31, 1996 options in respect of 283,000 shares were outstanding at prices ranging from $15.625 to $18.650 with a weighted average price of $17.605. Options vest at the rate of 20% on each of the five anniversaries of the date of grant. Options expire between May 2004 and March 2006.

6. Commitments and Contingencies

At December 31, 1996 the Company had outstanding letters of credit issued in lieu of holdbacks and performance bonds aggregating to $3,065,000, and had contracted to sell U.S. $12,500,000 at $1.359 in March 1997, all in the ordinary course of business.

7. Revenue

International revenues were $58,527,000 in 1996 ($31,711,000 in 1995) including exports from domestic operations of $38,687,000 in 1996 ($23,167,000 in 1995).

8. Income Taxes

The difference between the income tax provision using statutory income tax rates and the actual income tax provision is explained as follows:

	1996	1995
Income taxes calculated at statutory rates	$ 12,388	$ 12,009
Manufacturing and processing profits reduction	(1,160)	(1,399)
Other	6	159
Income tax provision	$ 11,234	$ 10,769

Financial Review – Eight Years

(Thousands of dollars, except per share data)

	1996	1995	1994	1993	1992	1991	1990	1989
Results								
Revenue	**245,922**	222,714	217,342	119,983	69,527	85,936	88,154	82,209
EBITDA	**32,437**	32,226	33,839	17,015	8,761	12,740	12,086	7,768
Income before income taxes	**27,777**	26,908	30,168	13,588	5,624	8,624	9,141	3,768
Net income	**16,543**	16,139	17,779	7,695	3,010	4,706	4,823	1,813
Interest expense	**763**	1,305	1,345	1,114	801	934	1,085	2,189
Depreciation and amortization	**3,897**	4,013	2,326	2,313	2,336	3,182	1,860	1,811
Cash from operations before changes in non-cash working capital	**19,667**	21,937	18,923	8,864	5,281	6,826	6,362	4,176
Capital expenditures, net								
Rental equipment	**(2,236)**	152	8,568	2,677	76	1,533	533	742
Property, plant and equipment	**2,722**	3,697	7,161	1,561	879	832	3,709	384
Dividends on common shares	**3,765**	3,767	2,644	2,600	41	–	–	–
Financial Position								
Working capital	**37,674**	26,862	12,989	12,515	12,597	8,642	6,432	7,537
Total assets	**106,398**	91,801	102,505	62,020	41,371	38,635	43,855	37,193
Long-term debt	**–**	4,634	4,716	4,792	4,862	3,500	3,500	5,361
Shareholders' equity	**66,407**	53,599	41,593	26,458	23,406	22,129	19,255	15,193
Ratios and Per Share Data								
Gross margin as % of revenue	**21.4**	22.3	23.6	23.2	23.5	23.7	23.0	19.0
Pre-tax income as % of revenue	**11.3**	12.1	13.9	11.3	8.1	10.0	10.4	4.6
Return on opening equity	**30.9**	38.8	67.2	32.9	13.6	24.4	31.7	12.0
Net income per common share – basic	**2.20**	2.14	2.35	1.02*	0.36*	0.57*	0.56*	0.15*
Price range – high	**36.50**	18.00	19.50	17.50	–	–	–	–
– low	**16.38**	12.25	14.00	12.00	–	–	–	–
– close	**33.00**	16.75	17.38	15.00	–	–	–	–

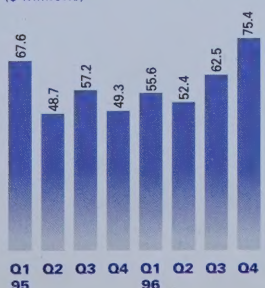
**Pro forma, based on 7,557,000 common shares outstanding after the public offering of September 1993.*

Financial Review – by Quarter

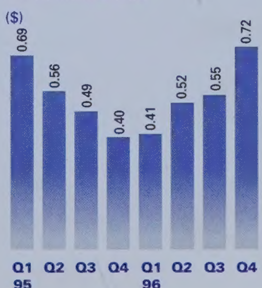
(Thousands of dollars, except per share data)

	1996				1995			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Results								
Revenue	**75,448**	62,484	52,363	55,627	49,316	57,171	48,656	67,571
EBITDA	**10,116**	8,148	7,776	6,397	6,362	7,518	8,465	9,881
Income before income taxes	**9,083**	6,960	6,569	5,165	4,999	6,197	7,029	8,683
Net income	**5,417**	4,152	3,909	3,065	3,015	3,731	4,207	5,186
Interest expense	**154**	195	187	227	298	301	420	286
Depreciation and amortization	**879**	993	1,020	1,005	1,065	1,020	1,016	912
Cash from operations before changes in non-cash working capital	**6,061**	4,997	4,907	3,702	5,117	4,587	6,259	5,974
Capital expenditures, net								
Rental equipment	**(491)**	(345)	(103)	(1,297)	(1,439)	1,142	(142)	591
Property, plant and equipment	**813**	551	917	441	528	1,153	498	1,518
Dividends	**941**	942	941	941	940	942	943	942
Ratios and Per Share Data								
Pre-tax income as % of revenue	**12.0**	11.1	12.5	9.3	10.1	10.8	14.4	12.9
Net income per common share – basic	**0.72**	0.55	0.52	0.41	0.40	0.49	0.56	0.69
Dividends per common share (cents)	**12.5**	12.5	12.5	12.5	12.5	12.5	12.5	12.5

Quarterly Revenues ($ millions)



Quarterly Net Income Per Common Share ($)



Corporate Information

Directors

P. John Aldred
President and
Chief Executive Officer
of the Company
Priddis, Alberta

Wayne S. Hill (1)(3)
Vice-President, Finance and
Chief Financial Officer
Toromont Industries Ltd.
Etobicoke, Ontario

Robert M. Ogilvie
Chairman of the Company
Chairman, President and
Chief Executive Officer
Toromont Industries Ltd.
Calendon, Ontario

J. Nicholas Ross (2)(3)
Chairman and
Chief Executive Officer
Rover Capital Corporation
Toronto, Ontario

Hon. Barbara J. Sparrow (1)
President, Sparrow Holdings Ltd.
Calgary, Alberta

Robert C. Williams (3)
Managing Director
Equity Capital Markets/Syndication
ScotiaMcLeod Inc.
Toronto, Ontario

Ronald G. Willox (1)(2)
Consultant
North York, Ontario

Note:
(1) Member of Audit Committee
(2) Member of Compensation Committee
(3) Member of Corporate Governance and Nominating Committee

Officers

P. John Aldred
President and
Chief Executive Officer
Priddis, Alberta

Wayne G. Adams
Vice-President, Marketing
Calgary, Alberta

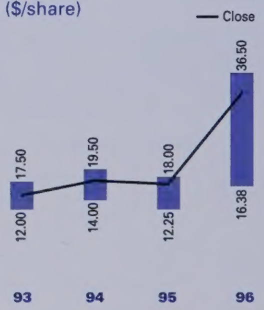
Niels W. Bang
Vice-President
Calgary, Alberta

Peter J. Conway
Vice-President
Calgary, Alberta

Malcolm R. Cox
Vice-President
Chestermere, Alberta

Robert S. Woodward
Vice-President,
Chief Financial Officer
and Secretary
Calgary, Alberta

Share Price
($/share)



Auditors
Arthur Andersen & Co.
Calgary, Alberta

Bankers
Canadian Imperial Bank Of Commerce
Calgary, Alberta

Solicitors
Bennett Jones Verchere
Calgary, Alberta

Transfer Agents
Montreal Trust Company Of Canada
Calgary and Toronto

Common Shares
Listed on The Toronto Stock Exchange
Stock symbol – EFX

Annual Information Form
Copies available on request to the Secretary of the Company

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